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6 November 1984

MEMORANDUM FOR: Director of Central Intelligence

VIA : Deputy Director of Central Intelligence
Executive Director
Deputy Director for Intelligence

FROM :
Director of Global Issues

SUBJECT : Your Next Meeting with McFarlane

1. Action: No action required, for your background use only.

2. Background: For your next meeting with Bud McFarlane you should be aware that he plans shortly after the election to raise with the President some new approaches the administration might take in dealing with the economic problems of LDCs. As I understand it, McFarlane has asked some members of the NSC staff to think about ways that the USG might respond to the needs of different groups of LDCs--for example, by in effect forgiving USG loans to the poorest countries, by seeking OECD reductions in trade barriers against the NICs, or by providing trade finance to debtors. The NSC apparently is also considering reviewing the AID program in part to increase US flexibility in responding to LDC requests.

3. McFarlane is not aware that Agency people have been consulted on this matter. Nevertheless, you might independently want to take this opportunity to discuss with him the study you commissioned last summer, titled "Economic Change and the Third World: Shifting Strategic Leverage." The draft, prepared by bears directly on the question of what Western governments might do through the support of private sector initiatives to restore or gain influence in the Third World. It has not been distributed outside the Agency.

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**Economic Change and The Third World:
Shifting Strategic Leverage**

Economics Division
Office of Global Issues

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Key Judgments

In many ways the past 20 years or so have been an age of opportunity for the Soviet Union in the Third World. Moscow's ability to quickly provide cheap arms, supply military personnel, and use subversion or military intimidation, coupled with an anti-Western predisposition among many Third World leaders, helped ensure a growing Soviet presence in the LDCs. [REDACTED]

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In more recent years, the Third World has been buffeted by low commodity prices, weakened export sales to Western markets hit by recession, and a growing debt burden. From an LDC perspective, this is only the first wave of economic problems. Looking down the road a few years, these difficulties will be joined by the impact of the high technology revolution, continued population growth, and a host of food, water, and other resource problems.

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While the difficulties faced by the LDCs are great, and indeed growing, they are also, if played correctly, an opportunity for a revival of Western influence in the Third World. More than ever before the LDCs need what only the West has to offer -- investment, technology, and viable export markets. If Third World nations can break local taboos against foreign sector investment and can mobilize the offerings of new technology, it is indeed possible that many of the difficulties facing individual LDCs can be turned into advantages. [REDACTED]

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In deciding the development path to follow, it is unlikely that Third World leaders will let the lessons of the NIC go unnoticed. While few may be able to emulate the NICs over the remainder of the decade, the open market, free enterprise approach that has fueled the NICs' success nevertheless holds promise for improving the economic posture of a wide range of LDCs.

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Investment opportunities abound in such different areas as energy exploitation, small investment opportunities, and local applications of new technologies to overcome existing shortages and bottlenecks. Already there are growing signs that some LDCs are beginning to reassess their policy towards the Western economic system. Investment barriers are beginning to be eased in some places. A growing number of countries are making innovative use of export processing zones and joint ventures. Moreover, public perceptions towards government regulatory practices and public employment are changing. While the steps taken to date are not earth shaking, they are at least in the right direction. [REDACTED]

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In the next few years Third World leaders will have to even more seriously assess the role and opportunities presented by the Western private sector. While there may be large pockets of internal resistance, the economic forces at play will, in time, make it clear to Third World leaders that the choice is either an innovative and dynamic use of private sector forces, or the risk of long-term economic decline. From a US perspective, the issue is not only ideological and humanitarian, but also one of strategic balance. This is underscored by the realization that if the LDCs do not respond to the opportunities they have, the Soviet Union's influence will grow by default.

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The Director of Central Intelligence
Washington, D.C. 20505

National Intelligence Council

NIC #06356-84
8 November 1984

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

THROUGH: Chairman, National Intelligence Council
Vice Chairman, National Intelligence Council

FROM: Fritz W. Ermarth
National Intelligence Officer for USSR

SUBJECT: Soviet Leadership Situation and Foreign Policy

1. Attached are two extremely valuable reports [redacted]

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[redacted] They deserve your careful reading before turning to the
points below.

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2. The reports make two basic points:

The senior Soviet foreign affairs establishment sees the trend of the overall "correlation of forces" as turning against the USSR in the 1980s and recognizes that current Soviet tactics on INF and other matters are not adequate to addressing the new situation.

The age and internal disarray of the Politburo, and the resulting infighting among top and second rank officials, have prevented coherent policy development and produced, instead, ill-considered ad hoc responses and hard-line posturing.

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Implications

4. The Soviets recognize the urgent need to change their tactics on the central arms control issues, and therefore toward the US and toward West Europe. But the condition of the leadership probably stands in the way. As a consequence, we can probably expect noticeable, but muffled and poorly executed steps toward arms control dialogue and atmospheric improvement in East-West relations.

5. [] a rough consensus that the right Soviet response to the new situation would be in the direction of Soviet retreat from confrontational policy lines and commitments, especially in more distant parts of the Third World. On the other hand, the Soviets will try, as one would expect, to stand firm in areas near their periphery, e.g., Afghanistan and the Middle East.

6. Given the leadership situation and the broader international context, it is doubtful whether the consensus suggested above embraces all the relevant institutions-- Central Committee apparatus, MFA, military, and KGB. [] incentive for some of them to engage in hard-line posturing probably creates some arguments for continuing the stone-wall line toward the West and perhaps for more risk taking in the Third World. But, because [] includes the all-important Central Committee foreign policy apparatus among those [] views [] one can infer that those arguing explicitly for more confrontational, hard-line policies have an uphill fight.

7. At the same time [] a situation in which lesser organs, such as the KGB and perhaps the Soviet military, have unusual freedom to pursue their own policy agendas with a view to influence the succession and policy choices. The pressures we continue to get around Berlin and the activism of reactionary thugs in Poland could arise from these conditions. The same conditions would be conducive in other areas to actions driven by the momentum of previous decisions.

8. This portrait of the Soviet leadership and its foreign policy predicament bears directly on US approaches to crisis management, specifically on our options toward Nicaragua. I see the following implications:

Except where Soviet central security interests are directly threatened -- which they definitely are not in Central America -- the Soviets will be inclined to cut their losses and retreat from confrontation where they lack massive local power to determine outcomes.

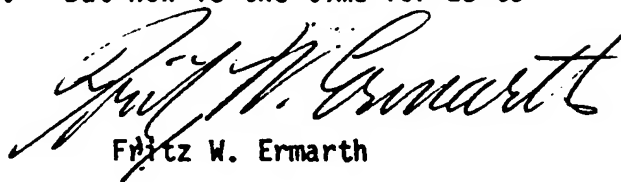
There may be some temptation for the Soviet leadership to "tough it out" and threaten escalation in the early stages of crises, before issues are clearly joined. But the political costs to contending leaders of a foreign policy disaster will be greater than the costs of well-rationalized retreat in the face of a locally stronger and determined adversary.

The potential for the Soviets to misread US intentions and determination is high because of bureaucratic indiscipline in Washington and rose-tinted glasses in the Politburo. This places the highest premium on quiet, firm control from the White House and the utmost clarity of purpose.

9. There are manifold risks and uncertainties confronting us [redacted]

All in all, however [redacted] US policies of the past several years plus the inner circumstances of the USSR have created the most attractive possible conditions for our defining how the superpower relationship should be structured and conducted for the rest of the decade and perhaps for years beyond. It will take a new leadership constellation for the Soviets to come to terms with a new "correlation of forces." But now is the time for us to create it.

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Fritz W. Ermarth

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